BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF THOMAS A. GEOFFROY

ON BEHALF OF THE FLORIDA DIVISION OF

CHESAPEAKE UTILITIES CORPORATION

DOCKET NO. 090125-GU

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Thomas A. Geoffroy. I am the Vice President of the Florida Division of Chesapeake Utilities Corporation ("Florida Division" or "Company"). My business address is 1015 6th Street N.W., Winter Haven, Florida 33882.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND RELEVANT PROFESSIONAL EXPERIENCE.

A. I attended the University of Florida and graduated in 1982 with a Bachelor of Science degree in Accounting. From 1983 through 1996, I was employed by Gainesville Gas Company and, subsequent to its acquisition in 1990, by the City of Gainesville. During my tenure there, I worked in various capacities, including Special Services Manager, in charge of customer service, accounting and information services. Next, I held the position of Controller and then Gas System Operations Director. I have been employed by the Company since 1996, first as the Florida Regional Manager, then as Assistant Vice President and currently as Vice President, responsible for all operations in the State of Florida.

Q. PLEASE DESCRIBE YOUR CURRENT RESPONSIBILITIES.

A. In my current position, I am responsible for all of the Company's Florida operations. My specific duties include setting goals and objectives for the business unit, strategic planning, presentation of capital, revenue and operations and maintenance budgets, and the oversight of the Company's regulated natural gas operations. In addition, I am responsible for managing the Company's Florida unregulated operations, including propane, gas marketing and intrastate pipeline activities.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will outline the organization of the Company's filing and present the witnesses who are providing testimony on the Company's behalf in this proceeding. I will provide an overview of Chesapeake Utilities Corporation and the Florida Division. I will describe the rate increase that the Company is seeking and summarize the necessity of seeking rate relief at this time. I will also describe the actions the Company has taken to avoid this proceeding. My testimony discusses the Company's business strategy and how it has been shaped by Consumer issues and regulatory and governmental policies, and why this case reflects the impacts of these outside influences. Next, I will discuss the regulatory surcharges that the Company is proposing to modify and to establish in this proceeding. I will outline the Company's Projected Test Year O&M Expenses. Finally, with the recent announcement of the Company's merger with Florida Public Utilities Corporation (FPU), I will discuss certain Company-proposed alternatives to the "contingency provisions" approved in the recent FPU natural gas rate case inclusive of the potential positive acquisition adjustment, transaction and transition costs.

Q. HOW IS THE COMPANY'S CASE ORGANIZED?

A. In support of its request for rate relief, the Company is submitting the "Investor-owned Natural Gas Utilities Minimum Filing Requirements" (MFRs), as provided in Commission Rule 25-7.039 Florida Administrative Code (F.A.C.), revised tariff sheets, and the testimony of the following witnesses:

1. Mr. Jeffrey S. Sylvester, Assistant Florida Regional Manager, will provide testimony regarding customer and volume forecasts, general business climate, and customer service enhancements.
2. Mr. Jeff Householder, of Jeff Householder & Company, Inc. will provide testimony regarding interim rates, miscellaneous revenues and charges, cost of service study, rate classification changes, rate design issues and tariff changes.
3. Mr. Matthew Dewey, Director of Business Unit Accounting, will provide testimony on general accounting issues, current and deferred income taxes and corporate and business unit allocation methods.
4. Mr. Randy Taylor, Director of Operations and Engineering, will provide testimony on the reorganization of the Company's operations department, the Company's projected 2009 and 2010 capital expenditures and certain system improvement projects.
5. Mr. Paul R. Moul, of P. Moul and Associates, Inc., will provide testimony on the appropriate cost of capital and return on equity for the Company.

6. Mr. William Pence, of Baker and Hostetler, will provide testimony on the Company's environmental clean-up site and the status of future requirements, timing and costs.

Q. ARE YOU SPONSORING ANY EXHIBITS IN THIS PROCEEDING?

A. Yes. Exhibit No. ____(TAG-1) details the number and type of customer complaints filed with the Florida Public Service Commission (Commission) since the Company's last rate filing. Exhibit No. ____(TAG-2) is a comparison of the Company's PGA rates and the NYMEX index prices for the period immediately prior to implementation of Phase 1 of the Company's Unbundling Program. Exhibit No. ____(TAG-3) is a comparison of the monthly NYMEX index price, selected LDC PGA rate and the Company's TTS Program's Standard Pricing Option rates since 2006. Finally, Exhibit No. ____(TAG-4) is a summary of the amounts collected through rates and actual costs incurred for the remediation of the Manufactured Gas Plant site since 1999.

Q. PLEASE GIVE A GENERAL OVERVIEW OF CHESAPEAKE UTILITIES CORPORATION.

A. Chesapeake Utilities Corporation ("CUC") is a diversified utility company engaged in natural gas distribution and transmission, natural gas marketing, propane distribution and marketing and advanced information services.

The natural gas distribution and transmission segment consists of three natural gas distribution divisions and the transmission businesses of Eastern Shore Natural Gas Company and Peninsula Pipeline Company. The three distribution divisions serve approximately 65,000 residential, commercial and industrial customers. CUC operates throughout central and southern Delaware and Maryland's Eastern Shore, and, as Central Florida Gas Company, in fourteen counties in Florida. CUC's propane distribution and marketing segment includes the operations of Sharp Energy and Xeron. Sharp Energy, based in Salisbury, Maryland, distributes propane to approximately 35,000 customers in central and southern Delaware, Pennsylvania and the Eastern Shore of Maryland and Virginia. Xeron, based in Houston, Texas, markets propane to large independent oil and petrochemical companies, resellers and southeastern retail propane companies. BravePoint, the advanced information services business unit, provides consulting, custom programming, training and development tools for national and international clients from their office in Atlanta, Georgia.

The Florida Division's regulated natural gas distribution operations serves residential, commercial and industrial consumers in the central Florida area, specifically Winter Haven, Plant City, St. Cloud, Inverness, Crystal River and many other nearby communities. In addition, the Company provides service to primarily industrial consumers in DeSoto, Gadsden, Gilchrist, Holmes, Jackson, Liberty, Suwannee, Union and Washington counties. The Company, through an approved territorial agreement, stands ready to provide service in certain agreed upon areas of Pasco County. The Florida Division also provides unregulated services, including propane distribution, natural gas marketing and intrastate pipeline activities.

Q. PLEASE DESCRIBE THE CURRENT CUSTOMER BASE OF THE COMPANY.

A. The Company defines "Customers" in its tariff as both Consumers and Shippers. Consumers are end use customers, including residential, commercial, industrial and special use consumers. Shippers supply the natural gas commodity to the Company's distribution system for transportation to Consumers. The Company transports gas delivered by Shippers to Consumers under its Transportation Service, subject to the Commission-approved tariff rules and regulations and rate schedules. Since November 2002, when the Company exited the gas supply merchant function, Shippers have delivered 100% of Consumer gas requirements on the Company's distribution system. The Company provides service to nine (9) CI Shippers and two (2) TTS Shippers.

As of December 31, 2008, the Company serves approximately 14,500 consumers in the service areas mentioned above. Of this total, approximately 13,350 were classified as residential consumers and 1,150 were classified as commercial or industrial consumers. The Company transported approximately 3,300,000 therms to residential consumers and 125,000,000 therms to commercial and industrial consumers. Large-use consumers (over 100,000 therms annually) continue to comprise well over 90% of the total system throughput. Industrial segments served include electric generation, phosphate and citrus industries, and a variety of other industrial applications. As will be described later in my testimony, the Company has seen a significant change in its industrial base since the last rate proceeding, including the addition of new industrial consumers and, more significantly to the instant case, the loss of existing industrial consumers.

Q. PLEASE DESCRIBE THE QUALITY OF SERVICE THAT THE COMPANY PROVIDES TO CUSTOMERS.

A. The Company has an excellent record of providing service to its customers as demonstrated by the very low number of complaints received by the Commission since our last rate proceeding. Exhibit No. ____(TAG-1) is a chart that depicts the number and type of complaints made to the Commission, beginning from the last rate proceeding through 2008. As indicated, all complaints have been resolved satisfactorily with the Consumer and have been closed. In addition, it is important to note that the Company was the first utility in the state to fully unbundle and did so soon after a similar effort occurred in Georgia. Unlike the Georgia unbundling program, the Company did not experience any issues that negatively impacted consumers and shippers. The Company implemented a well conceived unbundling plan, approved by the Commission, in an organized manner. Because of the Company's planning and implementation efforts, the transition to transportation-only service resulted in a high level of consumer satisfaction. In fact, no unbundling related complaints have been made to the Commission in the six (6) plus years that the program has been in place.

Q. IN GENERAL, WHAT RELIEF IS THE COMPANY SEEKING IN THIS RATE PROCEEDING?

A. The Company is proposing an increase in its base rates for consumers, shippers and Miscellaneous Service Charges. The resulting revenue increase would enable the Company to recover its investments to expand geographically, serve new consumers, and improve distribution system reliability. The Company's existing and planned capital investments have significantly increased rate base through the projected test year and are a major contributor to the Company's declining returns. In addition, the loss of revenue from industrial consumers terminating operations since the Company's last base rate proceeding are impacting the Company's ability to earn its authorized return. The Company is also proposing tariff modifications to, among other things, enhance customer service and reduce administrative complexities related to the provision of Transportation Service. The proposed base rates and other tariff changes will provide the Company a better opportunity to achieve its allowed rate of return, recover its cost of service and attract the necessary capital for the planned system improvements, customer growth and service enhancements detailed in this proceeding.

Q. WHAT LEVEL OF RATE RELIEF IS THE COMPANY SEEKING IN THIS CASE?

A. The Company is seeking approval of rates that will generate additional base revenues of $2,965,398 annually, or an overall increase of approximately 25%. The total proposed increase, on an annual basis, is below the compounded inflation rate of over 29% (see MFR Schedule C-37) since the historic base year in the Company's last rate case. The Company is proposing a return on equity of 11.5% that generates an overall midpoint rate of return of 7.15%.

Q. IS THE COMPANY ALSO SEEKING INTERIM RATE RELIEF?

A. Yes. Using the methodology authorized by the Commission, the Company has calculated that it requires interim relief of $417,555 based on the historical test year ending December 31, 2008. The specific calculations of both the interim and permanent revenue requirements are addressed in the testimony of Mr. Householder.

Q. WHEN WAS THE COMPANY'S LAST BASE RATE PROCEEDING?

A. The Company's last base rate case (Docket No. 000108-GU) was filed in May 2000. The final order (Order No. PSC-00-2263-FOF-GU) was issued on November 28, 2000. As contained in the final order, the Commission authorized the Company to revise its rates and charges so as to produce a return on equity ("ROE") within the range of 10.50% to 12.50%, with a midpoint of 11.50%. Subsequent to the base rate case, the Company filed separate rate reduction and revenue-neutral rate restructuring proceedings. The Commission approved each of these filing through Order Nos. PSC-03-0890-TRF-GU, issued August 4, 2003 and PSC-05-0208-PAA-GU, issued February 22, 2005, respectively. As a result, the Company was able to successfully realign costs between consumer and shipper rate classifications, adding additional rate classifications and increasing the proportion of margins received from fixed charges.

Q. IS THE COMPANY CURRENTLY EARNING A REASONABLE RETURN ON EQUITY?

A. No. The Company's achieved Rate of Return (ROR) as of December 31, 2008 was 6.20%. The Company projects that, absent rate relief, the ROR will deteriorate to 4.34% at December 31, 2009 and to 3.21% at December 31, 2010.

Q. WHY IS IT NECESSARY FOR THE COMPANY TO SEEK RATE RELIEF AT THIS TIME?

A. There are three primary reasons the Company is seeking relief at this time: 1) the effect on earnings due to the capital investments made by the Company for consumer growth in native and new geographic territories in the State; 2) system reliability enhancements and required facility relocation activities that need to be recognized in rate base so that the Company is afforded an opportunity to earn an adequate return on these investments; and, 3) significant revenue growth reductions, specifically declining residential growth and industrial load losses.

Q. PLEASE ELABORATE ON THE STATED THREE REASONS FOR RATE RELIEF.

First, since its last rate case, the Company has experienced significant consumer growth (over 50%, as shown on Schedule C-37). This growth can be partially attributed to the substantial population increase in the Company's native service territory located between Orlando and Tampa along the I-4 corridor. In addition, over the last several years the Company has implemented a strategy to expand geographically within Florida to reduce its historic dependence on industrial revenues, in particular revenues from the phosphate and citrus industries. The combination of native growth and expansion into new territories has resulted in significant investments in distribution facilities to provide service in these areas.

Second, with the dramatic population growth in the State of Florida over the past decade or so, the Company has of necessity enhanced its service reliability through distribution system infrastructure upgrades. These reliability enhancements support the substantial consumer and load growth in areas such as Citrus County, Plant City and Auburndale. Additionally, the Company established, in 2002, an interconnection with Gulfstream pipeline which accomplished three important objectives: 1) satified requests for higher operating pressures from the industrial and electric generation consumers in the Bartow service area; 2) improved system reliability for all consumers; and, 3) provided low cost pipeline capacity to support expansion. In 2009, the Company will enhance system reliability in Citrus County by adding two (2) new city gate stations, one in Lecanto to support new consumer growth, specifically a new cement plant, county schools and a future community college campus and the other near Homosassa Springs to support commercial and proposed residential growth near the SunCoast Parkway which connects this area with Tampa. The Company is also enhancing system reliability in the Auburndale area (in Polk County) with the purchase of two FGT laterals, one known as the Haines City lateral and the other known as the Winter Haven lateral. By purchasing these laterals and investing in related distribution main expansions, the Company is improving existing consumer service reliability in this constrained area of the Company distribution network. Mr. Taylor's testimony will further describe these capital projects in more detail. Population growth in the Company's service areas has necessitated numerous road expansion projects, many of which have required the relocation of the Company's facilities. For example, significant road widening projects on U.S. 27, County Roads 54 (in Polk County) and 486 (in Citrus County) have occurred since 1999 requiring the Company to either relocate its existing facilities or invest in new, replacement pipelines.

Finally, the current economic conditions have had a negative impact on the Company's growth and the projections are for this trend to continue at least through 2010. As a result of the financial market collapse and the bursting of the real estate bubble, the Company has experienced dramatic reductions in residential consumer growth in the last 12-18 months. In 2005-2007, the Company added an average (net of consumer loss) of 730 residential consumers per year. In 2008, that number reduced to 104 residential consumers and is forecasted to remain at about 100 net residential accounts on average for 2009 and 2010. The Company has also lost several industrial consumers due to the economic situation through plant consolidations and closures. Since late 2008, Golden Aluminum, Clark Environmental, Smithfield Lykes, and International Paper (Auburndale) have all either shut down their facilities, announced that they will be closing their facility or are utilizing an alternative fuel source, resulting in an annual loss of approximately five (5) million therms and approximately $450,000 of annual revenues for the Company. In addition to the projected usage declines in the phosphate industry, other industrial consumers have also experienced production level and natural gas usage reductions. Examples of these industrial consumers, which rely upon new residential and commercial construction, include James Hardie, Florida Brick and Monier Life Tile.

Q. WHAT HAS THE COMPANY DONE TO AVOID SEEKING A RATE INCREASE?

A. The Company has implemented several O&M cost containment programs that have resulted in 2008 expenses being well below the benchmark level, as shown on Schedule C-37, while also designed to meet the current and future needs of its consumers. Examples of such programs are:

- Implementation of Automated Meter Reading infrastructure that records daily usage information allowing the Company to significantly reduce the operating costs associated with manual meter reading (which only records one reading per month). The Company will also provide consumers with unparalleled shipper options and commodity pricing choices and shippers with near real time consumer usage information for daily and monthly balancing purposes. This project is more fully described in Mr. Sylvester's testimony.
- The Company's Operations Reorganization program aligns Company field personnel into regional and state-wide operational configurations consistent with strategic geographic expansion objectives. The Company has successfully provided quality service to consumers in these new geographic areas without the need for operational offices in each such area. This program is more fully described in Mr. Taylor's testimony.
- Personnel reductions and increased usage of the Energy Plus Partners (EPP) program – the Company reduced its operations personnel level from thirty-seven (37) positions in 2008 to thirty-three (33) positions in 2009 by further transitioning its "variable" tasks to the EPP network. The Company has made a concerted effort to identify multiple contractors in each of its service areas around the state. The Company invests considerable effort and resources to provide and sponsor on-going

technical training to ensure that its contractors meet required operator qualification standards. This program is also more fully described in Mr. Taylor's testimony.

Q. WHAT OTHER EFFORTS HAVE BEEN IMPLEMENTED BY THE COMPANY TO AVOID A RATE INCREASE?

A. Since it last filed for rate relief in 2000, the Company has developed and implemented a multi-pronged strategy to expand its historical focus on growth from industrial consumers to now also include residential and commercial consumers. This plan is predicated on the rapid population increase that has occurred in the early and mid-2000's, and, although Florida is in the midst of a population growth "pause," the projected continuation of a long-term growth trend at least through 2050.

First, the Company has dramatically expanded its geographic footprint into new areas of growth throughout the state, with the initial emphasis on seeking out and providing service to large industrial and commercial consumers thereby establishing the core infrastructure, with revenues to justify and support such costs, for the eventual growth in the residential and commercial sectors.

Second, the Company instituted a ground-breaking unbundling or open access program. The Company exited the retail gas supply merchant function, while developing a robust and consumer-friendly transportation service program, where consumers can not only choose their gas supplier (shipper) but also select from myriad pricing choices that are unparalleled in this state.

Next, the Company has embarked on aggressive promotion and utilization of its Commission-approved Energy Conservation programs to grow its consumer base while advancing the State of Florida's public policies regarding energy efficiency and carbon reduction.

Finally, the Company has implemented rate designs that not only allow it to aggressively promote its Energy Conservation programs but have allowed the Company to stabilize its revenues by gradually increasing the level of fixed charges that consumers pay for their Transportation Service.

Q. HAS THE MULTI-PRONGED STRATEGY BEEN EFFECTIVE?

A. Yes. As a direct effect of the strategy implementation and resulting actions described above, the Company has an impressive record of requiring only two (2) base rate increase filings since 1989 (the 2000 case and the instant case). The results speak for themselves: 1) the Company has successfully grown each sector of its customer base: consumers (residential, commercial, and industrial) and shippers. The total number of consumers has increased from 9,633 in 1999 to 14,520 in 2008, or an increase of over 50%. There are now eleven (11) approved shippers providing gas supply services to all consumers active in the Company's programs; 2) the Company's geographic footprint has increased from service provided in three (3) counties in 1997 to fourteen (14) in 2008; 3) the Company has the only transportation program in the state where residential consumers can currently choose from two suppliers (shippers) and from at least nine (9) pricing options, as well as, from two (2) transportation rate offering from the Company. In the most recent Open Enrollment process, more than 20% of the Company's consumers selected one or more of the available options; and 4) the Company's Energy Conservation programs have paid Commission-approved rebates to consumers to install natural gas appliances in 10,230 new homes and for 1,523 new or retained gas appliances in existing homes since the inception of these programs.

Q. PLEASE ELABORATE ON THE COMPANY'S STRATEGY.

A. The Company's natural gas distribution strategy has been developed and implemented during the last decade or so as described above. CUC's overall corporate strategy is to achieve steady and sustainable earnings growth through financially sound capital investments in the core regulated natural gas distribution business and to invest in related businesses and services that diversify the utility base and provide opportunities for returns that exceed traditional regulated utility returns. More specifically, the Florida Division's natural gas strategy is to expand geographically to capture profitable growth opportunities throughout the state that produce stable revenues from a diversified base of consumers. In order to do so economically, an increase in margins to support investments that serve residential and commercial consumers and reduce the historical Company dependence on industrial consumers was necessary. The Company's strategic decision to unbundle its system resulted in a reduction in gas supply costs, enabling the Company to expand its Commission authorized margins from its small volume consumer classes. The rates established in the rate proceedings described earlier provided revenues that generate positive returns on investment from residential and small commercial consumer classes. These revenues help support the

Company's efforts to expand its distribution system and continue to add residential and small commercial accounts. The diversification of revenues resulting from such growth has reduced the Company's dependence on industrial revenues.

Q. HOW HAS THE COMPANY'S STRATEGY BEEN IMPACTED BY THE CHANGES TO THE INDUSTRIAL MARKET?

A. As stated above, revenue growth from system expansion and the prudent management of expenses has achieved steady and sustainable earnings growth in the Company's core regulated natural gas distribution business. While historically the Company has focused on industrial consumers, the Company realized that this segment could no longer solely support the strategic needs of the Company. At the same time, the Company saw that residential and commercial growth in the state was increasing and was projected, over the next fifty years, to continue to be very strong. Our primary service territories, located between Orlando and Tampa along the I-4 corridor, were well positioned for the increase in population growth being experienced and projected. As described in my testimony in Docket 000108-GU, the mid to late 1990s saw dramatic contractions in the phosphate and citrus industries. Processing plants shut down and entire companies went out of business in and around the Company's then-existing service territory. In response, the Company made the decision that in order to meet its strategic objectives, it was necessary to focus on residential and commercial consumers, expand its geographic footprint and to "balance" its consumer base between residential, commercial and industrial. It is the

Company's belief that residential and commercial consumers produce more stable revenues over time than industrial consumers, in part because of the magnitude of industrial revenues. Losing an industrial consumer has a dramatic impact on the revenues of the Company; thus, the stability of earnings is not achieved. Since the last rate case, the Company has made significant progress in both areas. The Company has expanded geographically from three (3) counties in 1997 to fourteen (14) today. From 1999, the historic base year in our previous rate case, residential consumer growth has increased from 8,745 consumers to 13,369 consumers in 2008, or an increase of approximately 52% during the nine year period (almost 6% average residential growth rate per year). The industry average residential growth rate during this time period is less than 2% per year. Commercial consumer growth was 37% during this same time period.

Q. HAS THE COMPANY ABANDONED ITS EFFORTS TO ADD NEW INDUSTRIAL LOAD?

A. No. The Company has vigorously pursued industrial consumers since its last rate case in its native territory and in new geographic areas throughout the State. The Company has been successful in adding several large commercial and industrial consumers, including several state correctional institutions, a plant nursery, a mushroom-growing facility, cement plants and other facilities. These consumer additions have offset industrial consumer losses, which include Golden Aluminum, Smithfield/Lykes and International Paper (Auburndale) in 2008 and 2009 alone. In fact, despite plant closures and contractions in many industries, including phosphate and citrus, the Company's total throughput has increased from about 118 million therms in 1999 to over 128 million therms in 2008.

Q. ARE THERE OTHER CONSUMER RELATED ISSUES THAT HAVE AFFECTED THE COMPANY?

A. Yes. As noted above, population growth is expected to increase markedly over the next 40 to 50 years. The Company has been successful in establishing service to many new geographic areas of the state by finding large commercial and/or industrial accounts and extending distribution lines to provide service. The Company believes that substantial numbers of people will eventually choose to reside in these areas or in other areas that currently have virtually no access to natural gas service. The Company is well-positioned to provide service to these future residential and commercial consumers when this growth occurs. However, the traditional utility approach of establishing a physical presence in each remote territory, usually through an operations center, would, in the Company's view, not be prudent. Mr. Taylor's testimony further describes how the Company is providing service to consumers in all of the Company's diverse service areas.

Q. IS THE COMPANY'S GROWTH STRATEGY ALIGNED WITH FLORIDA'S PUBLIC POLICY OBJECTIVES?

A. Yes. The Company has, since 1984, been promoting Energy Conservation programs, through its approved Energy Conservation Cost Recovery (ECCR) program, to its residential and, on a more limited basis, commercial consumers. These programs are consistent with and promote the electric demand reduction goals of the Florida Energy Efficiency and Conservation Act (Section 366.80, Florida Statues). Natural gas consumers are encouraged to install energy efficient natural gas appliances. The elimination of standing pilot lights and the support of new technology appliances such as tankless water heaters are key elements of all approved energy conservation programs in this State. Generally speaking, the result of these efforts has been that the Florida natural gas industry as a whole has experienced a decline in usage by these specific appliances - water heaters, furnaces, ranges and clothes dryers. The Company is also experiencing a decline in usage *per appliance*. However, most gas utilities in this state have additionally reported a reduction in usage *per consumer* (see St. Joe Natural Gas, Peoples Gas and Florida Public Utilities recent rate cases). The Company's experience has not been consistent with other gas utilities. The Company's conservation program allowances have contributed to an increase in the number of appliances per premise (which reduces additional electric demand), resulting in annual residential usage *per premise* actually increasing slightly when compared to the historical base year in the Company's most recent rate proceeding (see Mr. Sylvester's testimony for further discussion). As a result, the Company's Energy Conservation programs are supporting the public policy goals for the more efficient use of natural gas, and an overall reduction in electric demand. While supporting these important policy objectives, the Company, as stated earlier in my testimony, has been able to increase revenues from residential and small commercial consumers through incremental realignment of its rate design so that more of the cost to serve is generated from fixed rates.

Q. PLEASE DESCRIBE HOW THE COMPANY CHANGED ITS RATE DESIGN SO THAT MORE MARGINS WOULD BE GENERATED FROM FIXED CHARGES.

A. The Company has achieved this incrementally through several rate proceedings since the late 1990's. The first step was achieved in the Company's 2000 rate proceeding, when the Commission approved rate schedules based on annual usage rather than the traditional classifications of residential, commercial and industrial; and separate rate schedules for sales and transportation service, with higher fixed charges assigned to the transportation rate schedules. In 2003, the Company filed to establish several small usage rate classifications, primarily for residential consumers, and reduce base rates for these consumers to reflect lower than expected costs to implement the Company's unbundling program. The Company received authorization from the Commission in 2005 for a revenue-neutral rate restructuring that eliminated all sales service rate classes, implemented rate classifications for third-party marketers and incrementally increased the fixed component, and lowered the variable component, of consumer rates. By setting rates to recover a larger percentage of margins from a fixed charge, the Company has successfully promoted conservation programs to the residential consumers without a significant negative impact to the total margins received from its residential consumers. Currently, the Company receives about 65% of its margins from fixed charges for the rate classifications (FTS-A through FTS-2) where residential consumers are prevalent. Thus, the reduction of usage *per appliance* does not have a dramatic impact on the Company's ability to generate sufficient margins to avoid rate proceedings or its desire to continue to promote energy conservation programs.

Q. PLEASE DESCRIBE HOW OTHER COMMISSION POLICIES HAVE AFFECTED THE COMPANY'S STRATEGY.

A. On April 4, 2000, the Commission adopted Rule 25-7.0335, F.A.C., requiring each local distribution company to offer gas transportation service to all non-residential customers. The rule further provided that each LDC "may offer the transportation of natural gas to residential customers when it is cost effective to do so." In accordance with the above rule, on May 15, 2000, the Company filed a proposed transportation service tariff, as a part of its request for a general rate increase. In addition to various tariff changes to modify the administrative procedures for its large volume transportation customers, the Company proposed a new Transportation Aggregation Service open to all non-residential customers regardless of consumption levels. Customers electing the proposed Transportation Aggregation Service would be required to enter into an approved aggregation pool, and to select from a list of qualified Pool Managers. By Order No. PSC-00-2263-FOF-GU, issued on November 28, 2000, the Commission approved the Company's proposals, with an effective date of March 2001.

Q. PLEASE DESCRIBE WHAT HAPPENED AFTER THE COMPANY IMPLEMENTED ITS TRANSPORTATION SERVICE PROGRAM.

A. In March 2001, when the Company implemented the expanded transportation service programs, thirty-five (35) large volume (>200,000 annual therms) industrial customers were already transporting. The new aggregated transportation service program provided transportation access to any non-residential customer. Response to the Company's transportation programs exceeded expectations. By the end of 2001, over 400 (approximately 40%) of the Company's non-residential customers were transporting, representing approximately 96% of the total system throughput. The remaining sales customers consisted of approximately 9,500 residential and small volume commercial accounts. The annual fuel requirements of these sales customers equaled approximately 3 million therms, less than 4% of the Company's total throughput.

The Company projected that gas costs, reflected in its Purchase Gas Adjustment (PGA) rate, for the remaining, primarily residential, sales customers would dramatically increase as a result of its implementation of Rule 25-7.0335, F.A.C. The cost increases were forecast, in part, based on the relatively small quantity of gas the Company would be purchasing for its sales customers. In addition, the allocation of interstate pipeline capacity costs was of significant concern. Historically, the cost of pipeline capacity was allocated to <u>all</u> customers through the Commission's PGA cost recovery procedures. As large volume industrial customers migrated to transportation, the Company had traditionally assigned capacity to the transporting customers based on their average monthly load requirements. This allocation method appropriately assigned the majority of the costs for capacity held for seasonal peaking and system growth to the residential and small commercial sales customers through the PGA. However, as virtually all of the Company's industrial customers and hundreds of smaller volume commercial customers migrated to transportation, the cost for peaking and growth capacity would be recovered primarily from the remaining residential sales customers. Under these circumstances, the Company recognized that it would become increasingly difficult to keep fuel rates competitive for its sales customers.

Q. WHAT WAS THE COMPANY'S RESPONSE TO THIS SITUATION?

To address the projected cost escalation for non-transporting customers, the Company, on March 28, 2002, filed a petition with the Commission to establish a three-phase Transitional Transportation Service (TTS) Program. Under the TTS program all remaining sales customers would be transferred to transportation service, the interstate pipeline capacity allocation method would be revised, and the Company would exit the retail gas sales merchant function. In Phase One of the TTS Program the Company proposed to select, through competitive bid, one third party gas marketer to serve as the Pool Manager for all TTS customers. In Phase Two the Company would, through competitive bid, select two Pool Managers. Initially, Phase Two customers would be randomly and equally distributed to each Pool Manager. At prescribed intervals customers would be able to switch Pool Managers and select from multiple pricing options. Phase Three would enable all customers to select from any of the Company's authorized Pool Managers. Customers would be free to negotiate services, terms and pricing from the Pool Manager of their choice.

By Order No. PSC-02-1646-TRF-GU, issued on November 25, 2002, the Commission authorized the implementation of Phase One of the Company's TTS program. The program was approved as an experimental and transitional pilot program under Section 366.075, Florida Statutes, with an effective date of November 5, 2002. The Commission ordered that any substantive change to the program, including proceeding to Phase Two, would require affirmative action on the part of the Commission. Under Phase One, the Company assigned 9,587 residential and 552 small commercial customers to Infinite Energy, the gas marketer selected to manage the TTS customer pool.

Q. HOW DID CUSTOMERS RESPOND TO THE COMPANY'S TTS PROGRAM?

A. Shortly after the TTS program was implemented, the Company received inquiries from a few very low use residential customers concerning their overall program savings. The Company worked with Commission staff to evaluate both current and projected savings for all TTS pool customers. Based on the analysis, it appeared that customers with one or two low-use appliances were not benefiting from the program. By petition filed with the Commission on May 16, 2003, the Company proposed to restructure its smallest volume rate class (0 to 500 annual therms) into three new rate classes, with lower monthly Customer Charges for the two smallest volume classes. The proposed rates reduced customer costs by approximately $298,000 per year. By Order No. PSC-03-0890-TRF-GU, issued on August 4, 2003, the Commission authorized the new rates and classifications, which became effective July 15, 2003. The restructured rates were designed to achieve an appropriate overall balance of Company revenues with TTS Phase One implementation costs, and to better ensure that all customers receive proportionate and immediate benefits from the program.

Q. WHAT DID THE COMPANY DO NEXT IN ITS TTS PROGRAM?

A. In August 2004, the Company filed a petition with the Commission requesting authority to restructure its rates and move toward recovery of costs through a higher fixed charge. Included in the Company's petition was a request to recognize Third Party Marketers (gas suppliers) as customers. The Commission approved the TPM rate classes and rates in Order No. PSC-05-0208-PAA-GU, issued on February 22, 2005. The Commission also approved a name change for both rate schedules to Shipper Administrative and Billing Service (SABS) and Shipper Administrative Service (SAS).

Q. PLEASE DESCRIBE WHY THE COMPANY PROCEEDED TO PHASE TWO OF ITS UNBUNDLING PROGRAM.

A. On October 10, 2006, the Company filed a petition (Docket No. 060675) requesting authorization from the Commission to implement Phase Two of its TTS Program. Several factors encouraged the Company to move to Phase Two. During the four years of Phase One operations, the Company gained significant experience and insight in the day-to-day operation of a transportation service environment. During Phase I, the Company received numerous requests from residential consumers for expansion of the program to include additional pricing options from more than one marketer. The Company did not, however, receive any requests from customers to return to merchant sales service. Several gas marketers had expressed interest in bidding to become a Phase Two TTS shipper and had indicated their ability to provided expanded pricing options to consumers. Finally, consumers were saving money through the program. The Company's petition (Appendix A) included a comparison of fuel prices under TTS Phase One to the Company's PGA rates for a two-year period prior to Phase One implementation using the monthly NYMEX settle price as a baseline index. The results indicated a substantial savings for TTS consumers. This comparison is attached as Exhibit No. ____(TAG-2). Moreover, the TTS program monthly index pricing was sending timely market price signals to the Company's TTS Program customers, whereas previously, the Company's PGA pricing frequently reflected over or under recovered costs from prior periods that resulted in monthly prices that varied significantly from the market price for natural gas.

By Order No. PSC-07-0427-TRF-GU, issued on May 15, 2007, the Commission authorized the Company to proceed to Phase Two of its TTS Program on an experimental, pilot basis. The Company's implementation of Phase Two included retaining two gas marketing firms (TTS Shippers) through a competitive bid process and assigning all TTS consumers, on a random and equitable basis, between the two TTS Shippers. Both Shippers initially served consumers under a Standard Price Option. The Standard Price Option was identical for all consumers, regardless of their assigned TTS Shipper. Between six and twelve months following Phase Two implementation, the Company administered an Open Enrollment Period wherein consumers were allowed to change Shippers or select from various pricing options offered by each Shipper. The Company provided each TTS Shipper the opportunity to promote their respective capabilities, various pricing options or other factors that would influence customer choice, to all TTS customers during an Open Enrollment

Period of approximately thirty (30) days duration. The Company administered the open enrollment process and mailed the TTS Shipper's solicitation materials to all TTS customers. Customers changing their TTS Shipper or selecting a new pricing option (fixed price or a change in index, etc.) could respond in writing to the Company. Company personnel processed all consumer selections. Those consumers not responding received the standard price option from their selected TTS Shipper. During the initial Open Enrollment offering, approximately 15% (a total of 2008 consumers) of the active TTS consumers elected to either change TTS Shippers or select a pricing option other than the standard price option. On April 1, 2008, the consumer choices from the Open Enrollment period were activated in the Company's billing system. Phase Two contemplates that the Company will administer an Open Enrollment process as described above on at least an annual basis throughout the period Phase Two is effect. In all other respects, Phase Two of the TTS Program operates in the same manner as approved by the Commission for Phase One.

In addition to approving Phase Two of the Company's TTS program, Commission Order No. PSC-07-0427-TRF-GU also approved an experimental fixed rate option for TTS Program participants in several small volume rate classes. The affected rate schedules (FTS-A, FTS-B, FTS-1, FTS-2 and FTS-3) include both residential and commercial consumers using less than 10,000 therms per year. The optional fixed charge rates eliminate the variable per therm usage charge and recover all costs through a fixed monthly transportation charge. The fixed rate for each respective class is derived from the revenue requirements approved for the class in Commission Order No. PSC-05-0208-PAA-GU, issued February 5, 2005. On January 17, 2008 the Company sent a letter to all existing TTS consumers offering the experimental fixed rate option. A total of 560 consumers selected the experimental fixed rate.

Q. HAS THE COMPANY OFFERED ANOTHER OPEN ENROLLMENT OPPORTUNITY TO ITS CONSUMERS?

A. Yes. The Company has recently concluded its second open enrollment period. The two approved shippers increased the number of pricing options offered to consumers and the response from consumers was strong, with 2,376 selecting a non-standard pricing program and 734 choosing the Company's experimental fixed rates. This equates to over 21% of eligible consumers selecting one of the options offered under this program in only the second Open Enrollment process.

Q. WHAT DOES THE COMPANY BELIEVE ARE THE RESULTS OF THE TTS PROGRAM?

A. The Company believes that there are two primary results of the TTS Program implementation. First, the Company's consumers have choices and options far beyond any other utility consumer in Florida. The Company's consumers can choose from two commodity providers, from a menu of supply pricing plans, and between traditional fixed/variable and fixed-only Company transportation rates. This strategic migration from the traditional utility sales service to today's offerings by the Company has occurred without any of the negative results that similar programs in other states have incurred. There has been no consumer "slamming;" consumers have received educational materials from the Company, assisting them in making informed decisions as to their supplier, pricing and transportation rate options; and, there have been no known complaints filed with the Commission regarding this program.

Second, the Company believes, and has demonstrated in its reports to the Commission on this program, that the consumer has saved significantly on the commodity portion of their natural gas bills. As shown in the first annual report for Phase 1 to the Commission, the results of this program were reductions in commodity prices, interstate capacity costs and related taxes and fees. These costs remain very competitive with the other major investor-owned LDC's in the state. Attached is Exhibit No. ____(TAG-3) which shows the comparison of the major LDC's residential PGA rates, the NYMEX prices and the Company's TTS Program's Standard Pricing Option rate since 2006.

The Company has continued its efforts to reduce commodity costs to the TTS program participants. As stated above, several industrial consumers are no longer receiving service from the Company. The interstate pipeline capacity associated with these industrial accounts has either remained with the shipper that provided service to the inactive industrial consumer or has been remarketed to other approved shipper's by the Company. A recent example occurred when the Golden Aluminum plant closed in October 2008. When the plant closed, 1,100 dekatherms per day of interstate pipeline capacity would have reverted to the TTS Shippers without action from the Company. The annual cost of this capacity to the TTS Shippers would have been approximately $160,000. The Company, however, proactively took steps to reduce the impact to the TTS residential and commercial consumers. The capacity was re-marketed to an existing shipper for several of the winter months at a discounted rate, with the remainder of the cost allocated to the Operational Balancing Account, in accordance with the Company's approved tariff. The Company then was able to remarket this capacity for the remainder of the Florida Gas Transmission (FGT) FTS-1 contract term (July 31, 2010) to a different shipper at maximum tariff rates. Prior to the Company's unbundling initiative, the unused capacity cost would have been absorbed in the PGA and charged to all sales, primarily residential, customers.

Q. PLEASE SUMMARIZE THE IMPACTS ON THIS PROCEEDING FROM IMPLEMENTATION OF THE COMPANY'S STRATEGIC INITIATIVES.

A. There are several impacts to the instant case from these issues that I can summarize. First, the rapid consumer growth and geographic expansions detailed above have resulted in a significant increase in the Company's rate base. Other rate base increases have occurred as a result of road widening projects requiring gas distribution main relocations and system reliability enhancements. This increase in rate base is one of the main drivers for the instant rate proceeding. Although the number of consumers receiving service from the Company is up over 50% from the last rate case, recent economic difficulties have slowed residential and commercial grow, consumer losses have increased (foreclosures and vacant homes) and industrial load losses and reductions have occurred. This is another significant driver for this case.

The Company's exit from the merchant function has resulted in significant savings and unparalleled choices for consumers in their fuel procurement activities. Additionally, the Company has made strategic investments in technology (AMR) and innovative methods to provide enhanced customer service (i.e., Energy Plus Partner program and operations reorganization) while containing the growth of expenses. Due to the implementation of these measures, O&M expenses have been contained and are, therefore, not a significant driver for this case. Finally, the implementation of the Company's strategy discussed in detail above provides the basis for the Commission to recognize the Company and its documented results of providing superior customer service, transportation offerings and customer pricing choices by authorizing a higher return on equity than recently awarded to other natural gas utilities.

Regulatory Surcharges

Q. PREVIOUSLY YOU MENTIONED THE ENERGY CONSERVATION PROGRAM, WHICH PROVIDES FOR A BILLING SURCHARGE TO RECOVER THE COMPANY'S PROGRAM RELATED COSTS. ARE THERE OTHER SURCHARGE MECHANISMS THAT THE COMPANY IS AUTHORIZED TO EMPLOY?

A. Yes. The Company, in addition to the ECCR surcharge, currently has a Competitive Rate Adjustment (CRA) surcharge mechanism to recover certain costs. As described earlier in my testimony, the Company provides service to many industrial accounts, several of which have viable alternatives to natural gas received from the Company's distribution system. From time to time, the Company receives requests to discount (reduce) its base rates in order to keep the industrial consumer from switching to its alternative fuel source. If the Company agrees to discount its base rates, half of the difference between the revenues that would have been generated at maximum tariff rates and the actual revenues received from the discounted rates is absorbed by the Company's shareholders. The other half of the discounted amount is recovered from all ratepayers, except those receiving a market-based rate, through the CRA surcharge.

Q. IS THE COMPANY PROPOSING TO MODIFY THE CURRENT CRA MECHANISM?

A. Yes. The Company is proposing to modify the current CRA mechanism so that all discounted revenues are recovered from ratepayers, except those receiving a market-based rate. The rationale for the sharing of the discounted revenues between the Company's shareholders and ratepayers was based on the conditions in place at the time this mechanism was created. In the early 1990's, the Company had many industrial customers on an interruptible rate. This rate was available for any industrial consumer that had viable alternative fuel capabilities. Because this rate was not always sufficient to keep consumers from utilizing alternative fuels, it was not uncommon for the Company to further discount its rate. However, when alternative fuels were more expensive than natural gas, the Company also had the ability to increase the tariff rates, and it shared the premium with the ratepayers in the same 50% proportion. Over the years, the Company eliminated its interruptible rate and now only offers discounts to tariff rates. There are no longer any premiums available for the Company to charge. As such, the Company believes that it should no longer be required to absorb any discount offered to industrial consumers. All ratepayers, especially residential consumers, benefit greatly (through lower rates) when large-use consumers with alternative fuel capabilities remain on-system, using natural gas. The large-use consumers, through the discounted rates they pay and through the release of interstate pipeline capacity, absorb significant fixed system costs that otherwise would be borne by all other ratepayers. Additionally, the current tariff mechanism provides sufficient protections to ensure that the alternative fuel price is legitimate and the Company's other ratepayers are not unduly bearing additional costs. If the proposed modification is approved, the Company will continue to have the ability to earn its authorized rate of return from industrial consumers who have alternative fuel capabilities. This proposal is consistent with a similar proposal approved by the Commission in Florida City Gas' Petition for Rate Increase, Order No. PSC-04-0128-PAA-GU, issued February 9, 2004, in Docket No. 030569-GU and should be authorized for the Company in this proceeding. Since there are currently no industrial customers receiving a discounted rate, there is no immediate effect to the other general body of ratepayers.

Q. ARE THERE OTHER RECOVERY MECHANISMS THAT ARE INCLUDED IN THE COMPANY'S BASE RATES INSTEAD OF A SEPARATE SURCHARGE?

A. Yes, the Company is currently recovering costs in its base rates related to the environmental cleanup of a former manufactured gas plant site in Winter Haven. As is more fully described in Mr. Pence's testimony, the Company is working with the Florida Department of Environmental Protection (FDEP) to remediate the site.

The Commission has long been supportive of the Company's efforts to clean the site by authorizing recovery of such costs. In Order No. 18202, issued on September 25, 1987, the Commission allowed recovery of certain costs in the Company's 1987 application for new depreciation rates. In Order No. PSC-93-0025-FOF-GU, issued on January 5, 1993, the Commission authorized amortization of such expenses at an annual rate of $71,114. In Order No. PSC-93-0520-FOF-GU, issued on April 6, 1993, the Commission ratified this authorization, while also allowing the Company to partially offset the expenses with 1991 overearnings, including accrued interest. In addition, in Order No. PSC-95-0160-FOF-GU, issued on February 6, 1995, the Commission permitted the Company to retroactively resume its $71,114 annual accrual to its environmental cleanup of the site, and allowed the Company to offset 1994 excess earnings against costs incurred in 1995. Similarly, the Commission allowed the Company to offset 1995 overearnings, by Order No. PSC-97-0136-FOF-GU, issued on February 10, 1997. Finally, the Commission reaffirmed the annual accrual to the environmental cleanup of the site in Order No. PSC-00-2263-FOF-GU, issued on November 28, 2000, the Company's last rate increase filing.

Exhibit No. ____(TAG-4) summarizes the annual amounts collected through rates and overearnings applied, as authorized by the Commission, and the annual amounts expended on the remediation of the MGP site. As of December 31, 2008, the Company has under-recovered its actual expenses by $268,257.

Q. WHAT IS THE CURRENT STATUS OF THE CLEANUP EFFORTS AT THE SITE?

A. As discussed in Mr. Pence's testimony, the environmental cleanup activities are nearing completion. Nonetheless, substantial costs will still be incurred (estimated at $600,000) over the next three or four years. Given the current under-recovery and the projected clean-up completion costs, which together total approximately $868,000, it would take over twelve (12) years to accumulate full recovery of the projected expenses applying the existing $71,114 in annual base rates.

Q. DOES THE COMPANY HAVE A SPECIFIC PROPOSAL TO MAKE REGARDING THE METHOD TO COLLECT THE REMAINING EXPENSES?

A. Yes. The Company proposes to establish a surcharge mechanism to more timely recover these costs from consumers and eliminate the environmental cleanup recovery of $71,114 annually from base rates. This surcharge mechanism will also allow the Company to immediately cease recovery from ratepayers when all cleanup costs are incurred and recorded, without an expensive rate filing to eliminate base rate revenues. The Company therefore is requesting Commission approval of the proposed environmental cost recovery surcharge mechanism. The initial level of the surcharge is proposed at $200,000 annually, effective January 1, 2010. In Mr. Householder's testimony, he describes the mechanism and specific factors to be applied to all applicable rate schedules. The Company would provide an annual report on the status of the cleanup efforts at the Winter

Haven site and a schedule reflecting both the cleanup costs and the amounts recovered from customers. Any change to the surcharge would require a filing with the Commission. All costs and recovery amounts would continue to be subject to Commission audit. A final true-up filing would be made after all expenses have been incurred and recorded, with a proposal to dispose of any over- or under-recovery.

Q. HAS THE COMMISSION IMPLEMENTED SIMILAR SURCHARGE MECHANISMS?

A. Yes. The Company believes that the Commission has the broad authority needed to approve recovery of environmental compliance costs through a surcharge mechanism. While our petition will outline more of the legal analysis on this point, I will just note that the Commission has implemented similar surcharge mechanisms. For example, the Commission approved cost recovery surcharges for Florida Power & Light Company and Progress Energy Florida, Inc. during the 2004 storm season. In Docket No. 041272-EI, Progress Energy petitioned the Commission for the establishment of a Storm Cost Recovery Clause asserting that because the unforeseeable costs incurred during the 2004 storm season had to be recovered from the ratepayers they necessarily must be recovered outside of base rates and a cost recovery clause mechanism was the only way to do that in a timely manner. By Order No. PSC-05-0748-FOF-FI, the Commission ordered that the storm costs approved for recovery would be treated as a temporary surcharge, rather than a cost recovery clause. Similar Commission decisions include Order No. PSC-05-0937-FOF-EI, issued on September 21,2005, in Docket No. 041291-El and Order No. PSC-05-0748-FOF-Fl, issued on July 14, 2005, in Docket No. 041272-EI. Finally, the Commission adopted and implemented the fuel clause pursuant to the Commission's broad rate-making authority.

Q. WHAT IF THE COMMISSION DECIDES TO DENY THE COMPANY'S REQUEST FOR THE SURCHARGE MECHANISM?

A. As an alternative to this proposal, the Company believes that it is necessary to increase the level of recovery through base rates from the current $71,114 to $200,000 annually. The filed revenue deficiency and proposed rates in this case do not reflect <u>any</u> amount for recovery of the environmental clean-up costs. If the Commission approves this alternative, or an alternative that authorized a different annual recovery amount, the revenue deficiency and final rates would need to reflect such approved recovery amount. Simply put, unless the commission approves the surcharge or the proposed alternative cost recovery, the Company's ability to complete remediation of the site will be in jeopardy.

<u>Projected Test Year O&M Expenses</u>

Q. IN THE MFR'S, DID THE COMPANY PROJECT O&M EXPENSES FOR THE 2010 TEST YEAR?

A. Yes, the Company projects O&M expenses, breaking out payroll and non-payroll expenses, as prescribed in Schedules G-2, pages 14 through 22. The Company utilized specific trending factors to project expenses from the actual historic base year of 2008 to the projected 2010 expenses. These factors include projected payroll increases, customer growth and inflation for 2009 and 2010. The factors are more fully described in Mr. Dewey's testimony.

Q. DID THE COMPANY DEVIATE FROM THE PROJECTED TEST YEAR O&M EXPENSE TRENDING METHODOLOGY INCLUDED IN THE MFR'S?

A. Yes. There are several specific O&M expenses that the Company deviated from the standard trending analysis in order to accurately project the 2010 O&M expense level. Each specific item is shown on Schedule G-2, pages 14 through 22 in the respective FERC account.

Q. PLEASE DESCRIBE THE SPECIFIC DEVIATIONS FROM THE TRENDING METHODOLOGY.

A. The Company has included the following adjustments to the O&M expense trending:

1. inclusion of costs (payroll and non-payroll) related to five vacant positions in the 2008 historic base year and two proposed new positions in 2009 ($362,836);
2. inclusion of costs (payroll and non-payroll) for the Assistant Florida Regional Manager position that was filled on January 1, 2009 ($155,382);
3. inclusion of projected rate case expense amortization ($68,750);
4. elimination of the non-recurring expenses incurred in 2008 related to an unconsummated acquisition ($155,634); and,
5. elimination of eleven (11) months of meter reading costs ($110,750), in accordance with the implementation of AMR infrastructure which

provides daily meter readings and Commission Order No. PSC-08-0730-PAA-GU, issued on November 3, 2008, resulting from the Company's Meter Read Waiver Rule petition.

Additional discussion of items 3 and 4 are contained in the testimony of Mr. Dewey and item 5 in the testimony of Mr. Sylvester.

It is important to note that the Company's O&M expenses for the *projected* test year (2010), inclusive of the above specified adjustments, are substantially lower than the benchmarked expense level shown on Schedule C-34 for the *historical* base year (2008).

Q. PLEASE DESCRIBE THE FIRST ADJUSTMENT LISTED ABOVE.

A. The first adjustment was made as a result of: 1) five vacant positions during 2008; and, 2) two new Transportation Service Administration (TSA) positions. The five vacant positions include an Engineering Manager, two Operations Technician positions, a Customer Service Specialist and a Support Specialist. These positions are required to be filled going forward to provide adequate customer and operations service to all consumers throughout the Company's service territory. As more specifically described in Mr. Sylvester's testimony, the Company is proposing to add two new TSA positions to provide adequate customer service to the Shippers doing business on the Company's distribution system.

Q. PLEASE DESCRIBE THE SECOND ADJUSTMENT LISTED ABOVE.

A. The second adjustment is for inclusion of costs for the Assistant Florida Regional Manager position in natural gas expenses. This position, which was filled on January 1, 2009, has responsibilities for the Customer Service, Customer Billing

& Records, Customer Support and Sales Departments of the utility and similar functions for the non-regulated businesses of the Company. The Company has proposed that 75% of the total costs for this position be included in the natural gas expenses in the instant case, based on the projected time allocations. It is anticipated that approximately 25% of this position's time will be allocated to non-regulated business activities and energy conservation programs.

Merger Discussion

Q. THERE HAS BEEN A RECENT PRESS RELEASE AND FILINGS WITH THE SECURITIES AND EXCHANGE COMMISSION (SEC) REGARDING THE PROPOSED MERGER WITH FLORIDA PUBLIC UTILITIES COMPANY. CAN YOU PLEASE ELABORATE ON THIS?

A. Yes. On April 20, 2009, the Company and Florida Public Utilities Company (FPU) announced in a press release that a definitive agreement to merge the two companies has been approved by the Board of Directors for both companies. This announcement went on to state that many regulatory and shareholder approvals were necessary to consummate this transaction and that if these approvals were obtained, the closing of the transaction was expected in the fourth quarter of 2009.

Q. WHAT IS THE CURRENT STATUS OF THE MERGER?

A. The merger is proceeding as planned. Several filings to obtain the required regulatory approvals have already been submitted. Each company's shareholder vote on the merger is anticipated to occur later this year. Although there is no certainty that the merger will be consummated, the original timing of the transaction closing remains unchanged at this time.

Q. HAVE YOU INCLUDED SPECIFIC INFORMATION ABOUT THE MERGER IN THIS RATE CASE FILING? IF NOT, WHY NOT?

A. No. The Company believes that it is premature to say that the merger definitely will be consummated or to have a thorough understanding of the detailed impact of the merger. As described above, several approvals need to be obtained before the closing of this potential transaction can occur. In the meantime, the Company, as a going concern, is in need of immediate rate relief and is entitled to such relief as supported in the instant case. As such, the Company's MFRs reflect only the facts and projections of the Company as a stand-alone entity. No attempt has been made to project the potential costs and savings of the transaction as it would be speculative and uncertain to do so.

Q. IS THE COMPANY AWARE OF THE COMMISSION'S ACTION REGARDING THE MERGER IN THE FPU NATURAL GAS RATE FILING?

A. Yes. The Company is aware that at the May 5, 2009 Agenda Conference, in the context of the FPU natural gas rate filing, the Commission discussed certain aspects of the merger with FPU, staff and the Office of Public Counsel (OPC). In the Commission's FPU Rate Order No. PSC-09-0375-PAA-GU ("FPU Rate Order") issued May 27, 2009, a "contingency provision" was included requiring actions by FPU applicable in the event the merger is completed. The "contingency provisions" included in the FPU Rate Order provides that: 1) a new docket will be opened; 2) FPU shall file MFRs and testimony (reflecting at a minimum, the effect of the merger, the synergies of the merger, and the change in capital structure), within 180 days from the date the merger is consummated, based on a 2011 test year; and, 3) the increased revenues granted by the FPU Rate Order shall be held subject to refund from the date that the merger is consummated. The Company is also aware that on June 17, 2009, OPC filed a protest to the FPU Rate Order, primarily related to the potential merger.

Q. GIVEN THAT THE COMPANY'S MFR'S DO NOT INCLUDE MERGER INFORMATION IS THE COMPANY WILLING TO ACCEPT A SIMILAR "CONTINGENCY PROVISION" IN THIS CASE?

A. Yes. The Company is prepared to accept the same "contingency provision" that the Commission ordered in the FPU natural gas rate filing. In such instance, the Company would proceed as a combined entity with FPU to prepare and file a full rate case within 180 days from the closing date of the merger using 2011 as a projected test year.

Q. DOES THE COMPANY BELIEVE THAT THERE IS AN ALTERNATIVE TO THE "CONTINGENCY PROVISION" THAT BETTER PRESERVES AND PROTECTS THE INTERESTS OF ALL STAKEHOLDERS?

A. Yes. The Company believes that it is appropriate for the combined company to prepare a "come-back" filing, similar to the one ordered by the Commission in the FPU case. However, the Company believes that the limited certainty of any merger related information that could be provided in a filing made only 180 days after closing would not be in the best interests of any of the stakeholders. If the merger is consummated, the combined company will face a lengthy transition period as it works to integrate the operations of its units. Given the time needed to prepare the MFR's and testimony, only very limited actual post-merger information would be known at the time of the 180 day filing. In addition, the FPU contingency provision does not address several significant aspects of the merger including the disposition of the positive acquisition adjustment and the associated transaction and transition costs. The Company would like to work with the Commission and OPC to develop a more comprehensive plan to review the merged entity that can be implemented to the benefit, and in the best interests, of all stakeholders.

Q. WHAT DOES THE COMPANY PROPOSE?

A. The Company's proposed alternative contingency provision includes certain actions in this filing and a "come-back" filing eighteen months following the merger closing which would include a comprehensive review of the effects of the merger.

Assuming that the merger is consummated, the Company proposes that the Commission adopt an alternative merger contingency plan as part of this rate proceeding. The alternative contingency plan would apply to the combined company. The Company's alternative contingency plan seeks Commission approval of five (5) primary components:

1. Shift the "come-back" rate case filing from 180 days to 18 months following closing;
2. Authorize CUC to suspend the amortization of the positive acquisition adjustment recorded in Account 114 – Gas Plant

Acquisition Adjustments until final disposition in the "come-back" filing;

3. Authorize CUC to record transaction and transition costs as Regulatory Assets and suspend the amortization of these costs until final disposition in the "come-back" filing;

4. In the interim between the merger closing and the final order in the "come-back" case, direct the combined company to file quarterly surveillance reports, as required by Commission Rule 25-7.1552, clearly indicating the effects of the merger; and,

5. In the interim between the merger closing and the final order in the "come-back" case, authorize the combined company, if its earnings level exceeds the high point of the authorized Return on Equity, inclusive of the positive acquisition adjustment, transaction costs and transition costs as part of rate base, to begin amortizing the positive acquisition adjustment and Regulatory Assets at such amounts to reduce the earnings level to the high point of the authorized Return on Equity for the combined company.

Q. PLEASE PROVIDE ADDITIONAL DETAIL OF THE COMPANY'S "COME-BACK" RATE CASE PROPOSAL.

A. The Company is specifically proposing the following "come-back" rate case provision:

1. Following the merger, the combined company would submit a rate case filing that enables the Commission (and OPC) to review the impacts of the

merger. Such filing would be made no later than eighteen (18) months after the closing date of the merger. The proposed filing timeframe would allow the combined company to identify any actual or anticipated savings, synergies, recurring and non-recurring costs and other merger results;

2. The combined company would file a full rate case, inclusive of MFRs and Testimony, and would use 2010 as its Historic Base Year, the first full year after the anticipated closing date, and 2012 as the Projected Test Year;

3. In the proposed filing, the combined company would consolidate their respective tariffs into one common tariff;

4. All actual and projected savings, synergies, recurring and non-recurring costs and other results of the merger through 2012 shall be included in the rate filing;

5. The combined company would propose to begin recording the amortization of the positive acquisition adjustment in Account 406 – Amortization of Gas Plant Acquisition Adjustments and demonstrate the appropriateness of such accounting through the Commission five-factor test;

6. The combined company would propose a specific disposition of the Regulatory Assets (transaction and transition costs); and

7. Any recurring savings presented in the 2012 projected test year above the amount required to recover the amortization of the acquisition adjustment and Regulatory Assets would have the effect of reducing consumer rates.

Q. HAS THE COMMISSION ADOPTED AN ACCOUNTING METHOD FOR ACQUISITION ADJUSTMENTS?

A. Yes. The Commission has adopted the Code of Federal Regulations, Subchapter F – Accounts, Natural Gas Act, Part 201 (the "Code") for accounting practices of regulated natural gas companies. The Code specifies that acquisition adjustments be accounted for as Utility Plant in Account 114 – Gas Plant Acquisition Adjustments. The Code defines the acquisition adjustment as "the difference between (a) the cost to the accounting utility of gas plant acquired as an operating unit or system by purchase, merger, consolidation, liquidation, or otherwise, and (b) the original cost, estimated, if not known, of such property, less the amount or amounts credited by the accounting utility at the time of acquisition to accumulated provisions for depreciation, depletion, and amortization and contributions in aid of construction with respect to such property." The Code goes on to state in subsection C of Account 114 that "Debit amounts recorded in this account related to plant and land acquisition *may* be amortized to account 425, Miscellaneous Amortization, over a period *not longer than* the estimated remaining life of the properties to which such amounts relate. Amounts related to the acquisition of land only *may* be amortized to account 425 over a period of *not more than* 15 years. Should a utility wish to account for debit amounts in this account in any other manner, it shall petition the Commission for authority to do so." [emphasis added]. It does not, however, prescribe when the amortization begins.

Q. HAS THE COMMISSION PREVIOUSLY ACTED ON ANY NATURAL GAS COMPANY'S REQUEST TO ACCOUNT FOR TREATMENT OF ACQUISITION ADJUSMENTS IN ANY OTHER MANNER?

A. There are a number of instances where the Commission has approved requests by companies to record the amortization of acquisition adjustments in a manner other than in account 425 – Miscellaneous Amortization. Most recently, in the NUI Corporation purchase by AGL Resources Inc. ("AGLR") (Docket No. 060657-GU), the Commission ruled favorably on recording the acquisition adjustment in account 406 – Amortization of Gas Plant Acquisition Adjustments ("above-the-line"). In Order No. PSC-07-0913-PAA-GU, the Commission stated that "[a]cquisition adjustments have been allowed in extraordinary circumstances if a company could demonstrate that customers will derive certain benefits attributable to the acquisition." The Commission has historically considered five factors when determining whether the recognition of an acquisition adjustment is appropriate for a natural gas utility. Those factors are:

1. Increased quality of service;
2. Lower operating costs;
3. Increased ability to attract capital for improvements;
4. Lower overall cost of capital; and
5. More professional and experienced managerial, financial, technical and operational resources.

The Commission, in said order, also stated that it is appropriate to consider such recognition because "[s]uch an adjustment provides an incentive for stronger companies to purchase weak or troubled companies."

In the action described above, the Commission appears to recognize that it is appropriate for both the company and customers to receive benefits from the transaction.

Q. YOU STATE ABOVE THAT IT DOES NOT APPEAR THAT THE CODE PRESCRIBES THE BEGINNING DATE FOR THE AMORTIZATION OF THE ACQUISITION ADJUSTMENT. CAN YOU ELABORATE?

A. Yes. As noted in the above-referenced citations to the Code, the debit amounts recorded *may* be amortized to account 425 over a period *not longer than* the estimated remaining life of the properties. The Code does not prescribe when the amortization should begin. In order to determine when this should occur in this case, the Company reviewed the definition of "Amortization" in the Code, which states: "*Amortization* means the gradual extinguishment of an amount in an account by distributing such amount over a fixed period, over the life of the asset or liability to which it applies, or over the period during which it is anticipated the benefit will be realized." This language provides for a different beginning point for the amortization – either tied directly to the life of the asset or when the benefits are realized. In this case, the Company believes that the acquisition adjustment should begin when "the benefit will be realized."

The Company believes that the Code would account for the purchase price as follows: 1) record the plant assets of the acquired company at book value; and

2) record the premium as an acquisition adjustment. The benefits that the Company receives from the assets recorded at book value are realized immediately upon closing from the revenue from rates established to recover the cost of service, including the return component, related to these assets. The depreciation (amortization) of these assets also begins immediately upon closing. Thus the benefits match the costs of this portion of the transaction.

However, the acquisition adjustment would not be recovered from the Commission-approved rates in place at the time of closing. As noted above, the Commission's historic five-factor acquisition adjustment test seeks to ensure that customers recognize benefits from an acquisition or merger prior to authorizing the re-classification of the acquisition adjustment amortization from Account 425 (below-the-line) to Account 406 (above-the-line). The benefits resulting from the acquisition, as established in the Commission's test, are derived from lower operating costs, which occur subsequent to the time of closing. In the Company's view, the definition of "amortization" in the Code and the "matching principle" of Generally Accepted Accounting Principles, would defer the amortization of the acquisition adjustment until the lower operating costs (benefits) are realized.

The Company is proposing to amortize the transaction costs, transition costs and the acquisition adjustment over time in a manner that more closely matches the timing of the benefits of the acquisition. The majority of the cost savings are expected to be implemented during the first twelve months after the transaction closes. The cost savings are also expected to grow over time. Conversely, the impact on revenue requirements of the acquisition adjustment and the regulatory assets is at its peak on day one and declines over time as the costs are amortized. By delaying the amortization, the Company would improve the matching of the benefits (cost savings) with the associated costs (recovery of the regulatory assets and the acquisition adjustment).

The Company believes that the language in the Code provides the Commission with broad discretion to determine when the amortization of the acquisition adjustment should begin and to approve the proposed accounting treatment suggested by the Company. The Company's proposed alternate contingency provision provides a balanced means to match the benefits of the transaction with the costs of the transaction as indicated above. If approved by the Commission, the amortization of the acquisition adjustment would be suspended until the final disposition of the "come back" filing, unless the operating savings subsequent to closing place the combined company in an over-earnings situation. If this were to occur, then the Company's proposal would begin the amortization of the acquisition adjustment at such amounts necessary to reduce the combined company's earnings to the top of the authorized range. For this unique situation, and given the posture of the announced merger, the Company believes that its proposal provides the most equitable means to hold both shareholders and customers harmless pending the "come-back" rate case, while also providing a clear point of entry in that "come-back" filing for a complete review and participation by all stakeholders.

Q. THE COMPANY IS PROPOSING TO ESTABLISH TRANSACTION AND TRANSITION COSTS AS REGULATORY ASSETS. WHY IS THIS APPROPRIATE?

A. By establishing the transaction and transition costs as regulatory assets, the Company would be afforded the opportunity to match these specific costs of the transaction with the benefits. These costs can be specifically attributed to the transaction components: either the plant assets of the acquired company or the premium paid and recorded as an acquisition adjustment. If these costs are associated to the plant assets, they should be amortized over the approved life of the plant assets, approximately 30 years on average. If these costs are associated with the premium paid and recorded as an acquisition adjustment, they should be amortized concurrent to the anticipated operating savings. The Company therefore believes that the transaction and transition costs should be recorded as Regulatory Assets, with the amortization suspended until the disposition of the "come back" filing, unless the operating savings subsequent to closing place the combined company in an over-earnings situation. If this were to occur, then the Company's proposal is to begin the amortization of the regulatory assets at such amounts necessary to reduce the combined company's earnings to the top of the authorized range.

Q. IS THE COMPANY'S PROPOSED TREATMENT OF THE AMORTIZATION OF THE ACQUISITION ADJUSTMENT AND REGULATORY ASSETS CONSISTENT WITH THE AGLR CASE?

A. It differs somewhat. In Docket No. 060657-GU, the AGLR acquisition adjustment filing was made almost two (2) years after the closing of its acquisition of NUI Corporation. The Company, in this case, is seeking Commission approval, in advance of the merger closing, of the above stated alternative contingency provision related to the positive acquisition adjustment and Regulatory Assets.

Specifically, in Docket No. 060657-GU, AGLR sought regulatory treatment for the positive acquisition adjustment and certain regulatory assets (transaction and transition costs and pension costs) "after the fact." AGLR did not request a rate adjustment as part of its filing, but was seeking a determination that the positive acquisition adjustment and the associated annual amortization be included in rate base and cost of service, respectively. AGLR also was seeking certain accounting treatments for the incurred transaction and transition costs, as well as, pension costs. The Commission, by Order No. PSC-07-0913-PAA-GU, issued on November 13, 2007, approved recording the positive acquisition adjustment, transaction and transition cost amortizations "above the line", with on-going review of these actions.

In this case, the Florida Division is not seeking "approval" of the positive acquisition adjustment or transaction and transition costs at this time, only that these items be established as Utility Plant and Regulatory Assets, respectively, and that the amortization of these items be suspended until the "come back" filing, anticipated to be filed in 2011. The Company believes that approval of the proposed alternative contingency provision is consistent with the Commission's adopted accounting procedures and is in the best interests of all stakeholders.

Q. HOW DOES THE COMPANY'S PROPOSAL AFFECT CUSTOMERS?

A. The Company's proposal does not have any immediate effect, positive or negative, on customers, because the Company is not seeking any changes in customer rates as a result of any of the merger related activities. The customers do receive benefits from the "come-back" filing which provides a mechanism that will enable all stakeholders to assess the impacts of the merger and afford the Commission an opportunity to set rates that appropriately reflect the combined company's costs. In the long-term, subsequent to both filings, customers will also benefit from a stronger combined company than either company would be individually; and, rates would be lower than what would be expected if the two companies remain separate. Under this proposal, both the customers and the combined company are "held harmless" until disposition of the "come back" rate case, with the burden of proof clearly on the shoulders of the combined company to demonstrate that this transaction does indeed produce significant benefits to customers and that the five-factor test of the Commission for authorization to amortize the acquisition adjustment "above the line" is met.

Q. WHAT WILL THE IMPACT ON THE COMPANY BE IF THE COMMISSION APPROVES THE SAME PROVISIONS FOR THE COMPANY AS IT DID IN THE FPU RATE CASE?

A. In the Company's opinion, the existing Commission-ordered provisions for FPU may not provide an adequate level of assurance required for CUC to defer the transaction and transition costs as Regulatory Assets and record the excess cost over book value as an acquisition adjustment, as opposed to goodwill. The existing Generally Accepted Accounting Principles without the regulatory accounting treatment would require the Company to expense all transaction and transition costs when incurred. The acquisition adjustment premium would be recorded as an asset ("goodwill"), which would not be amortized but would instead be subject to periodic impairment assessments based on future fair value of the combined company. The amount and timing of impairment charges from "goodwill," if any, would depend on, among other things, future state of capital markets and the combined company's future operating results, including the combined company's ability to generate increased earnings from anticipated synergies. CUC will be required to make its judgment on the appropriate accounting for the merger prior to the reporting of the 2009 year-end financial results.

The Company believes that this approach does not match the benefits of the merger with the costs of the transaction, which could unnecessarily and irreparably harm the combined company's shareholders and could serve as a disincentive to the merger despite the Company's belief that the merger would benefit customers.

Summary

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. The Company, even during these uncertain times, has fared differently than other utilities. Primary factors driving the need for rate relief are increases in rate base and reduction of industrial revenues. Because of the Company's efforts, O&M expenses have been controlled since its last rate case proceeding through restructuring of its business philosophy, as described herein, and implementation of technological improvements. Customer service has been enhanced through the Company's Unbundling Program, resulting in lower fuel costs to all consumers as well as unparalleled pricing options and choices. Furthermore, the implementation of the Automated Meter Reading infrastructure has enhanced usage information to shippers and consumers. The Company believes that for all of the reasons stated herein, the proposed Return on Equity for the Company, which is higher than what the Commission has recently approved for other natural gas utilities, is warranted. Due to the investments made by the Company detailed herein, reduced industrial revenues and the significant reduction in residential and commercial growth, a rate increase is currently required, after nine (9) years, to afford the Company an opportunity to earn a fair return on its investment and attract the necessary capital for further growth throughout its existing service territories and for expansion into additional un-served areas of the State.

Finally, the Company is looking forward to the potential merger with FPU and the many benefits that this transaction should produce for all stakeholders. The Company has proposed certain ratemaking treatment that should allow for a fair and more fact-based review of the affected companies prior to and after the merger, should it take place.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

Florida Division of Chesapeake Utilities Corporation

Docket No. 090125-GU

Summary of Customer Complaints

Submitted to the Florida Public Service Commission

		Type					
Year	**Number**	**High Bill**	**Non-Payment**	**Billing**	**Est. Meter**	**Mail**	**Misc.**
2000	2	1					1
2001	11	5			4		2
2002	14	6	1	3	2	1	1
2003	12	3	1	5	1	2	
2004	8	4	1	1			2
2005	4		3	1			
2006	11	2	5		2		2
2007	8	3	3				2
2008	4	1	1		1		1
2009	6	1	2		2	1	
Total	80	26	17	10	12	4	11

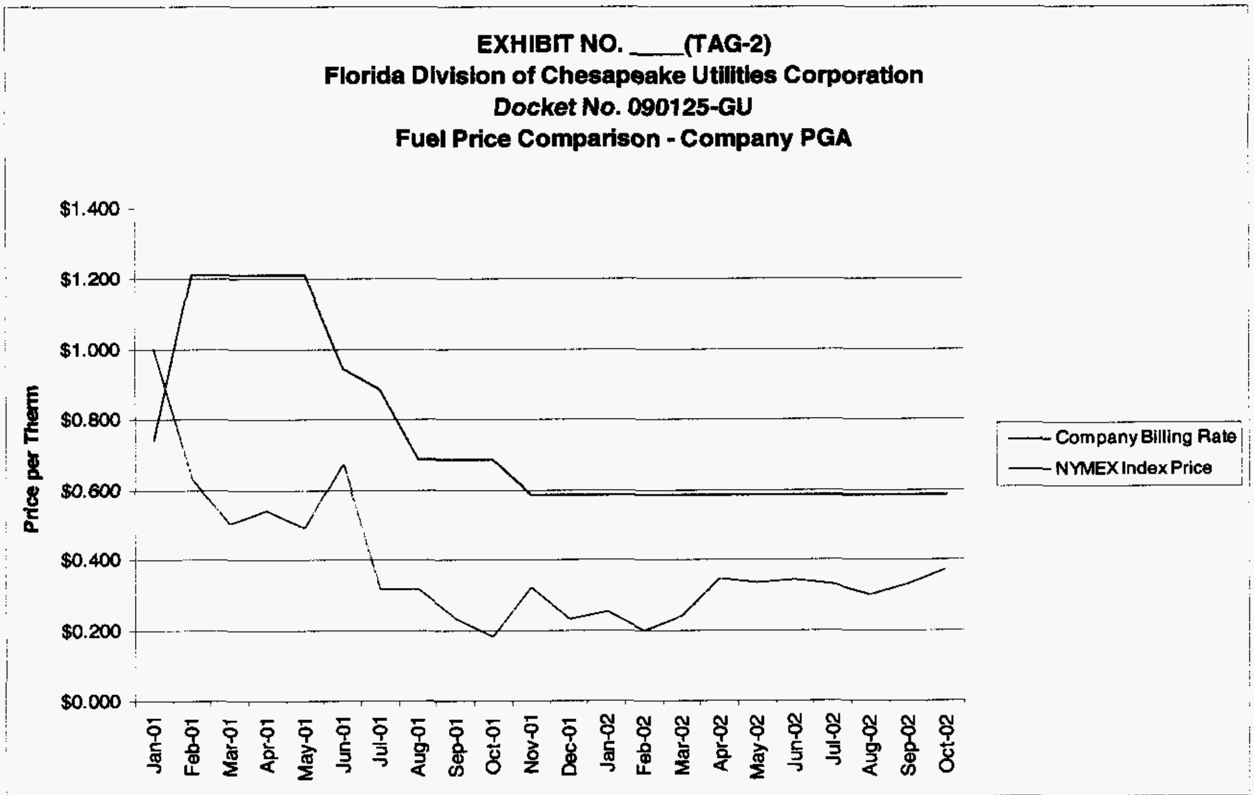
EXHIBIT NO. ____(TAG-2)
Florida Division of Chesapeake Utilities Corporation
Docket No. 090125-GU
Fuel Price Comparison - Company PGA
Price per Therm
$1.400
$1.200
$1.000
$0.800
$0.600
$0.400
$0.200
$0.000
Jan-01
Feb-01
Mar-01
Apr-01
May-01
Jun-01
Jul-01
Aug-01
Sep-01
Oct-01
Nov-01
Dec-01
Jan-02
Feb-02
Mar-02
Apr-02
May-02
Jun-02
Jul-02
Aug-02
Sep-02
Oct-02
Company Billing Rate
NYMEX Index Price

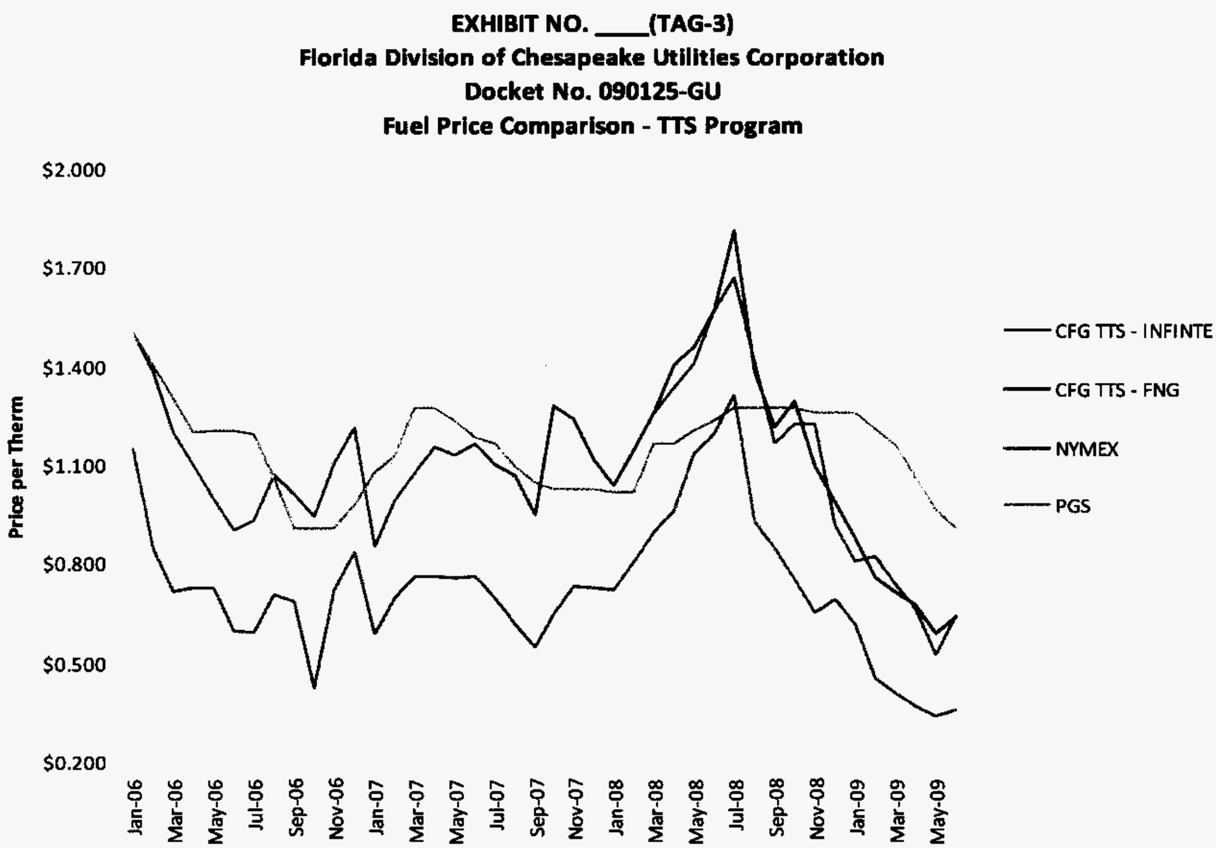
EXHIBIT NO. ____(TAG-3)
Florida Division of Chesapeake Utilities Corporation
Docket No. 090125-GU
Fuel Price Comparison - TTS Program
$2.000
$1.700
$1.400
$1.100
$0.800
$0.500
$0.200
Price per Therm
Jan-06
Mar-06
May-06
Jul-06
Sep-06
Nov-06
Jan-07
Mar-07
May-07
Jul-07
Sep-07
Nov-07
Jan-08
Mar-08
May-08
Jul-08
Sep-08
Nov-08
Jan-09
Mar-09
May-09
CFG TTS - INFINTE
CFG TTS - FNG
NYMEX
PGS

FLORIDA DIVISION OF CHESAPEAKE UTILITIES CORPORATION

SUMMARY OF AMOUNTS COLLECTED THROUGH RATES AND COSTS INCURRED FOR THE REMEDIATION OF THE MANUFACTURED GAS PLANT SITE

Date	Amounts Collected	Overearnings Applied	Costs Incurred	Over (Under) Collected
Beginning Balance @ 12/31/99				$ 504,710
12/31/2000	$ 71,114		$ 17,443	$ 558,381
12/31/2001	$ 71,114		$ 106,773	$ 522,722
12/31/2002	$ 71,114		$ 318,663	$ 275,173
12/31/2003	$ 71,114		$ 137,185	$ 209,102
12/31/2004	$ 71,114		$ 97,782	$ 182,434
12/31/2005	$ 71,114		$ 96,117	$ 157,431
12/31/2006	$ 71,114		$ 138,671	$ 89,874
12/31/2007	$ 71,114		$ 176,438	$ (15,450)
12/31/2008	$ 71,114		$ 323,921	$ (268,257)